

February 20, 2004

Docket Control – Docket No. RE-00000C-00-0377
Arizona Corporation Commission
1200 W. Washington
Phoenix, AZ

RE: Environmental Portfolio Standard Change Workshop #1 Comments

Mr. Ray Williamson / Ms. Barbara Keene:

The purpose of this letter is to respond to your e-memos dated February 6, 2004 and February 17, 2004 by submitting comments for the first Environmental Portfolio Standard Change Workshop #1. Tucson Electric Power's (TEP) comments address procedural matters as well as renewable energy issues which the company believes should be addressed at future Commission workshops where possible changes to the Environmental Portfolio Standard (EPS) may be considered.

An Important Financing Factor Influencing the Success of the Current EPS

TEP has been an active participant in the proceedings and workshops regarding the EPS and believes that the EPS has been primarily responsible for providing the program and funds that has resulted in Arizona being a national leader of solar energy generation development. The EPS is providing a wealth of credible information regarding the costs and performance of renewable generation. Additionally, the EPS has made available real-time data that the utilities can use in understanding the characteristics of intermittent renewable resources like solar and wind for eventual integration into the grid dispatch portfolio.

The EPS funding mechanism allows for finance-free renewable resource asset development because it supports "Pay as You Build" financing. The initial installation of renewable generation is generally capital extensive, while the cost of operation is low. A dramatic reduction in the life cycle cost of renewable generation can be realized when financing costs are eliminated. Since up-front funding is available, the financial risk of entering into long term contracts for energy developed from a declining cost technology is reduced.¹ Furthermore, utilities can reinvest the revenues derived from sale of solar generated electricity into additional funding for renewable generation in following years.²

TEP strongly recommends any changes to the EPS include the mechanism for up front funding embodied in the current EPS.

¹ Long term contracts entered into for energy from a declining cost technology like solar will always have a higher net present value per unit of energy than building the technology with the same cash flow as dollars are available. Long term contracts are appropriate when the technology has matured, the prices are stable and robust competition is supported.

² These new dollars will be available for leverage as the cost of solar technologies declines in future years, further increasing the effectiveness of those revenues for funding solar generation development in the future. These revenues benefit all customers, not just those installing PV systems.

Critical Procedural Issues for the EPS Workshops

The Commission has directed that a series of Workshops be held around the state to gather input on possible revisions to the current EPS. TEP recommends the following guiding principles be used in conducting the Workshops and developing the final report requested by the Commission:

- Establish the Scope of Workshops
- Set the rules for conducting the Workshops in the first Workshop.
- Determine what will constitute consensus in the first Workshop.
- Data based on actual Arizona conditions should be differentiated from data based on hypothetical programs in the Workshops and in the final report.
- All presentation series should be provided in a balanced forum with adequate and reasonable time for all views to be presented and information supplied.
- The full economic impact of all financial inputs to renewable energy development should be used in all reporting.
- The final report should be crafted in a collaborative environment by a Committee, appointed by the Director of the Utilities Division, with representation essentially equivalent to the representation on the Cost Evaluation Working Group, in a manner to provide for continuity of experience from the CEWG to the new committee.
- The final report should include the opportunity for minority positions to be incorporated into the report.
- Input should be sought from energy consumers regarding their willingness to financially support the EPS.

Critical Technical and Economic Issues for the EPS Workshops

The Workshops should address, at a minimum, the following technical and economic aspects of renewable generation:

- Quantity, quality and location of Arizona's renewable resources.
- Location of population centers with respect to the location of the renewable resources.
- Capacity, location and cost of additional electrical transmission needed to move renewable energy to the population centers.
- Time variance of renewable resources with respect to time variance of Arizona electrical loads.
- Environmental impact of development of renewable energy generation resources.
- Current costs and impacts of developing the various renewable energy resources.
- Future costs and impacts of developing the various renewable energy resources.
- The role of DSM as an energy resource and the associated costs to consumers and Arizona.
- The technical and economic opportunities and challenges anticipated by all ACC jurisdictional utilities to support a standard customer-sited renewable subsidy program.

- The Commission has indicated that the Arizona EPS annual energy percentage goals may seem low compared to the adopted renewable energy goals of other states and have asked that the workshops consider the question of increased annual renewable energy percentage goals for Arizona. As part of this discussion in the Workshops, the renewable energy programs of other states with higher annual energy percentage goals should be reviewed in terms of the funding levels and funding sources provided for those programs and whether these programs will in fact meet their annual renewable energy percentage goals with the funding provided. This should include a review of the definition of renewable energy in those states, performance of the renewable portfolio standards to date and actual annual renewable energy production percentage results of, at a minimum, the states of Nevada, New Jersey, California and Texas.

Critical Issues for the Future EPS

All parties to the Cost Evaluation Working Group (CEWG) reported that the EPS, as originally envisioned, did not provide sufficient funding for all utilities to meet the EPS annual renewable energy goals in the timeframe required.

It is strongly recommended that any future EPS provide sufficient funding sources to insure EPS success by all utilities, without deferral of revenue recovery to future years. Therefore, TEP urges the Commission to provide sufficient funding through the Portfolio Standard surcharge and System Benefit Charge without deferral of those costs for recovery in future years. Enhancing the funding mechanism should ensure a realistic opportunity for success of all utilities in meeting the EPS annual energy percentage goals with a prudent renewable energy development program.

The current EPS is energy based. This has proven to provide a better means of program performance verification than the capacity based program of some other states. TEP strongly recommends that the concept of an energy based EPS be retained in any changes to the EPS. To properly implement an energy based EPS, all individual qualifying renewable sources that are capable of producing more than 1,000 kWh, or energy equivalent, of renewable energy per year should be metered. This will prevent use of inaccurate formula based annual energy predictions that allow for over reporting of renewable energy production. Arizona energy customers deserve a renewable energy program that reports real energy production results, not one based on laboratory simulations and mathematical models.

The EPS should build confidence in the energy consuming public that renewable energy sources will provide the annual energy and cost savings advertised. The public should be provided with honest information regarding the performance, safety and reliability of renewable energy systems based on proven Arizona experience. This need for accurate and truthful information about renewable energy generation is essential if renewable energy programs are to build public confidence in renewable energy sources necessary for long term EPS program success.

The Arizona utilities and TEP in particular, have developed renewable generation resources at the direction of the Commission as a result of both the 1993 Integrated Resource Planning process and through the first three years of the 2001 EPS. These renewable generation resources should qualify as renewable resources to meet any future EPS with a minimum of the same annual energy percentage weight as they currently qualify. Similarly, Arizona solar manufacturing facilities currently qualifying for EPS credit reductions should be qualified to provide the same level of renewable energy credit reductions under any new EPS. TEP strongly recommends that past investment in Arizona-based renewable development should be recognized and rewarded in any changes to the EPS.

Sincerely,

Tucson Electric Power Company

David Couture